



# Arizona Tax Conference 2017

## August 31, 2017 – Good Tax Administration with a Focus on Property Taxes

Presented by:

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**COST**<sup>®</sup>  
COUNCIL ON STATE TAXATION



# Agenda!

- **State Business Tax Burdens**
- **Federal Legislation on SALT Issues**
- **Corporate Income Tax Updates**
- **Sales Tax Updates**
- **Property Tax Updates**



# **State Business Tax Burdens**

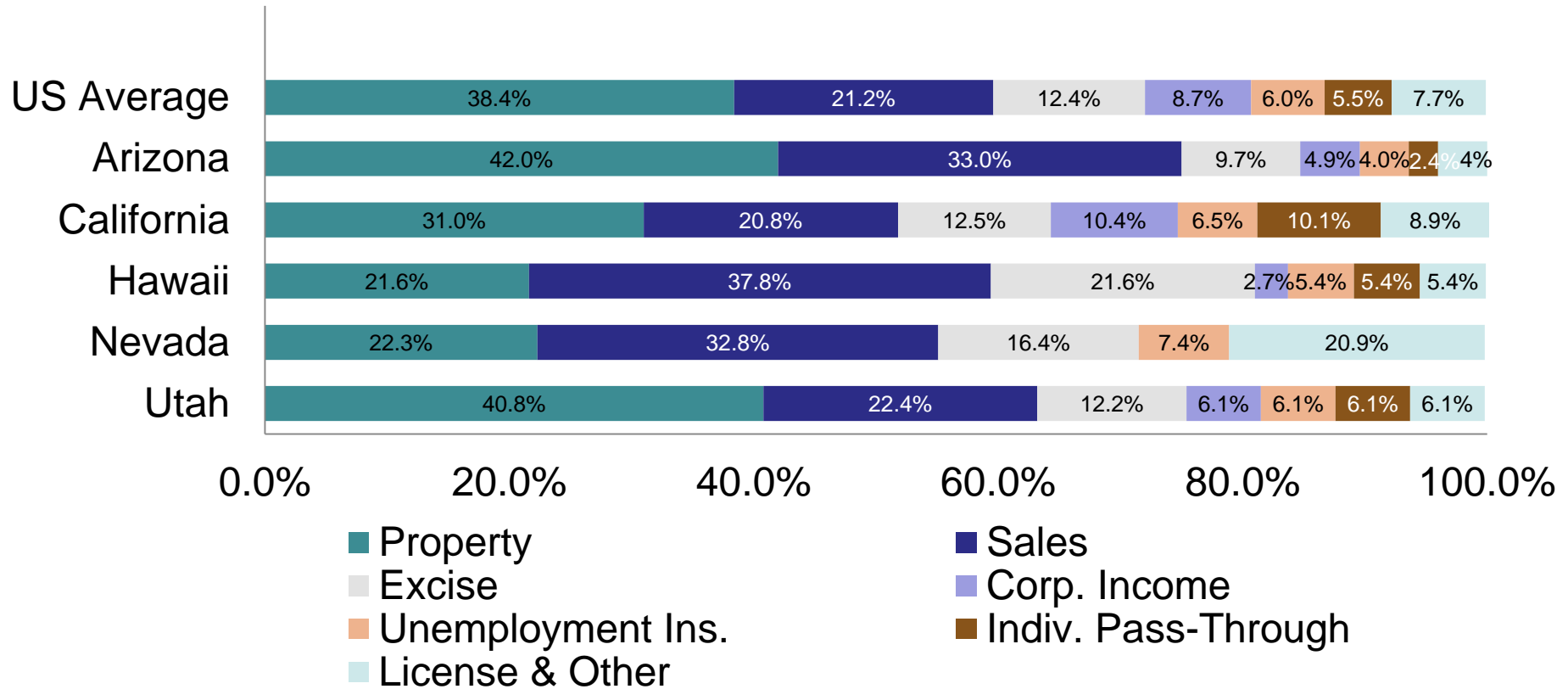
# What do Businesses Pay?

- **Businesses paid more than \$724.1 billion in state and local taxes in FY 2016, an increase of 0.9% from FY 2015**
- **How much do businesses contribute to state revenues?**
  - **US Average for FY 2016: 43.9% of all tax revenues**
    - **Pacific Southwest states for FY 2016:**

Arizona: 49.6%	Nevada: 52.3%
California: 38.9%	Utah: 41.5%
- **Remarkably, the business share of SALT nationally has been within 1% of 45% since 2000**

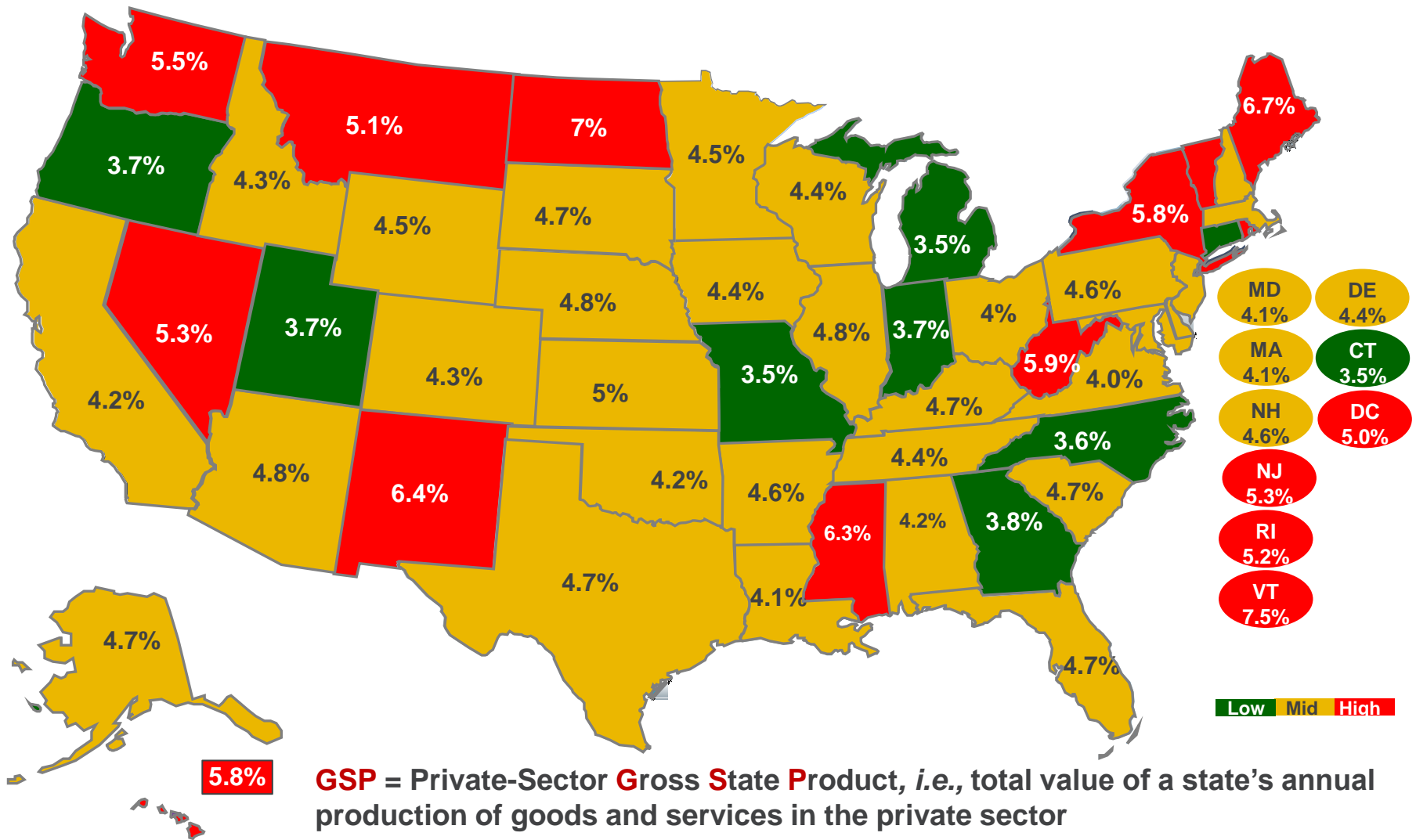
*Source: Total State and Local Business Taxes: State-By-State Estimates for Fiscal Year 2016 COST, STRI and Ernst & Young, Expected Publication August 2017*

# U.S. Average v. Pacific Southwest Comparison



Source: Total State and Local Business Taxes: State-By-State Estimates for Fiscal Year 2016 COST, STRI and Ernst & Young, Expected Publication August 2017

# Business Taxes As a Share of Private Sector GSP, FY 2016



Source: Total State and Local Business Taxes: State-By-State Estimates for Fiscal Year 2016 COST, STRI and Ernst & Young, Expected Publication August 2017 <sup>6</sup>



# **Federal Legislation on SALT Issues**



# Mobile Workforce State Income Tax Simplification Act of 2017

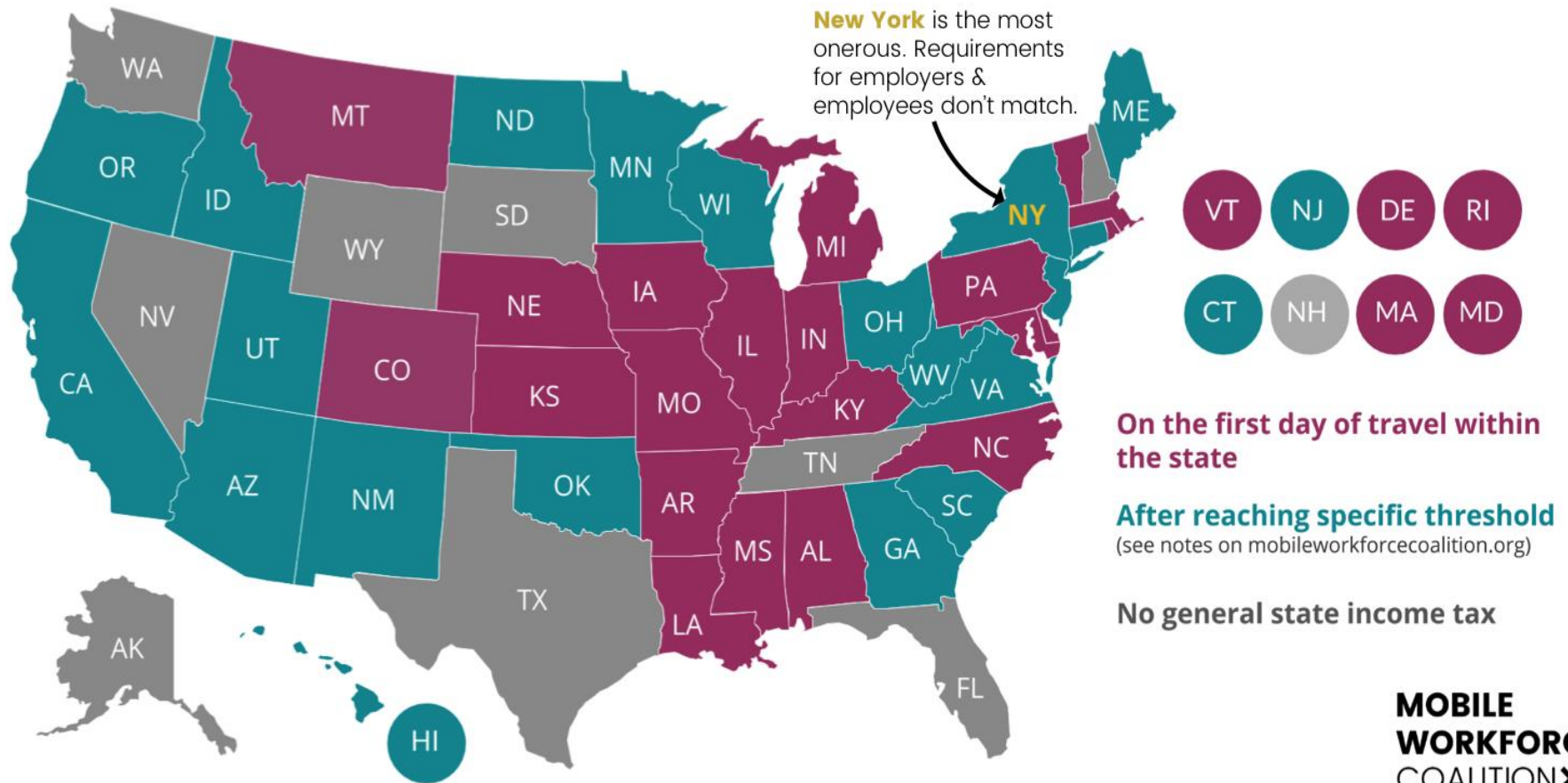
- Senate: S. 540 was introduced by Sens. John Thune (R-SD) and Sherrod Brown (D-OH) (March 7, 2017)
- House: H.R. 1393 was introduced by Reps. Mike Bishop (R-MI) and Hank Johnson (D-GA) (March 7, 2017)
- **House passed on June 20, 2017 (*third time's the charm?*)**
  - Creates a bright-line, 30-day threshold before state employer withholding and personal income tax liability would apply
  - Exceptions for entertainers, athletes, certain film production employees & prominent public figures
  - Many industry members and organizations (300+) support the bill
  - 58 House cosponsors
  - 53 Senate cosponsors

**[www.mobileworkforcecoalition.org](http://www.mobileworkforcecoalition.org)**



# A Patchwork of Nonresident State Income Tax Withholding Laws

## When is a nonresident employee subject to withholding?



# State Remote Seller Collection Authority

Since 2005, the following legislation has been proposed:

- Main Street Fairness Acts (MSFA)
- Marketplace Equity Act (MEA)
- Marketplace Fairness Acts (MFA)
- Remote Transactions Parity Act (RTPA)
- Online Sales Simplification Act (OSSA - draft)
- No Regulation Without Representation Act (*Keep Quill*)

## Current Legislation in the Congress:

**Remote Transactions Parity Act, H.R. 2193**, introduced by Rep. Kristi Noem (R-SD) on April 27, 2017 – 35 Cosponsors

**Marketplace Fairness Act of 2017, S. 976**, introduced by Sen. Mike Enzi (R-WY) and Dick Durbin (D-IL) on April 27, 2017 – 24 Cosponsors

**No Regulation Without Representation Act, H.R. 2887**, introduced by Rep. Sensenbrenner (R-WI) on June 12, 2017, Subcommittee hearing on July 25 – 9 Cosponsors

# The Preserving Taxpayers' Rights Act

Introduced on July 13 as H.R. 3220 by Rep. Jason Smith (R-MO) with five bipartisan cosponsors (7 current cosponsors)

This measure proposes to reform certain Internal Revenue Service administrative practices by making them fair, efficient, and effective for both the Government and the taxpayers by:

- providing taxpayers with a legal right to contest tax disputes with the IRS before an impartial and independent IRS Office of Appeals
- limiting IRS removal from Appeals to only those cases that involve recurring tax abuse impacting a large number of taxpayers
- limiting IRS use of designated summonses that lengthen the tax liability assessment period to only when taxpayers are uncooperative and withhold requested information
- preventing the recent IRS practice of outsourcing audits of private taxpayers to outside law firms from becoming routine

***[www.eetax.org](http://www.eetax.org)***

# Other Potential Legislation?

Legislation not yet introduced in the 115<sup>th</sup> Congress:





- **Business Activity Tax Simplification Act**
  - Legislation would modernize P.L. 86-272 by including sales of services and would apply more broadly than just net income taxes imposed by the states
  - Puts in a bright line **14-day presence test**, with exceptions, before an entity is subject to a state's "business activity" taxes and would not allow *Finnigan* apportionment (including a unitary entity's sales in the group's sales factor even when that entity does not have substantial nexus with the taxing state)
- **Digital Goods and Services Tax Fairness Act**
  - Bill would prevent multiple and discriminatory taxes on digital goods or services
  - Provide specific sourcing mechanism based on "customer address" which is hierarchical and similar to the sourcing under the **SSUTA**

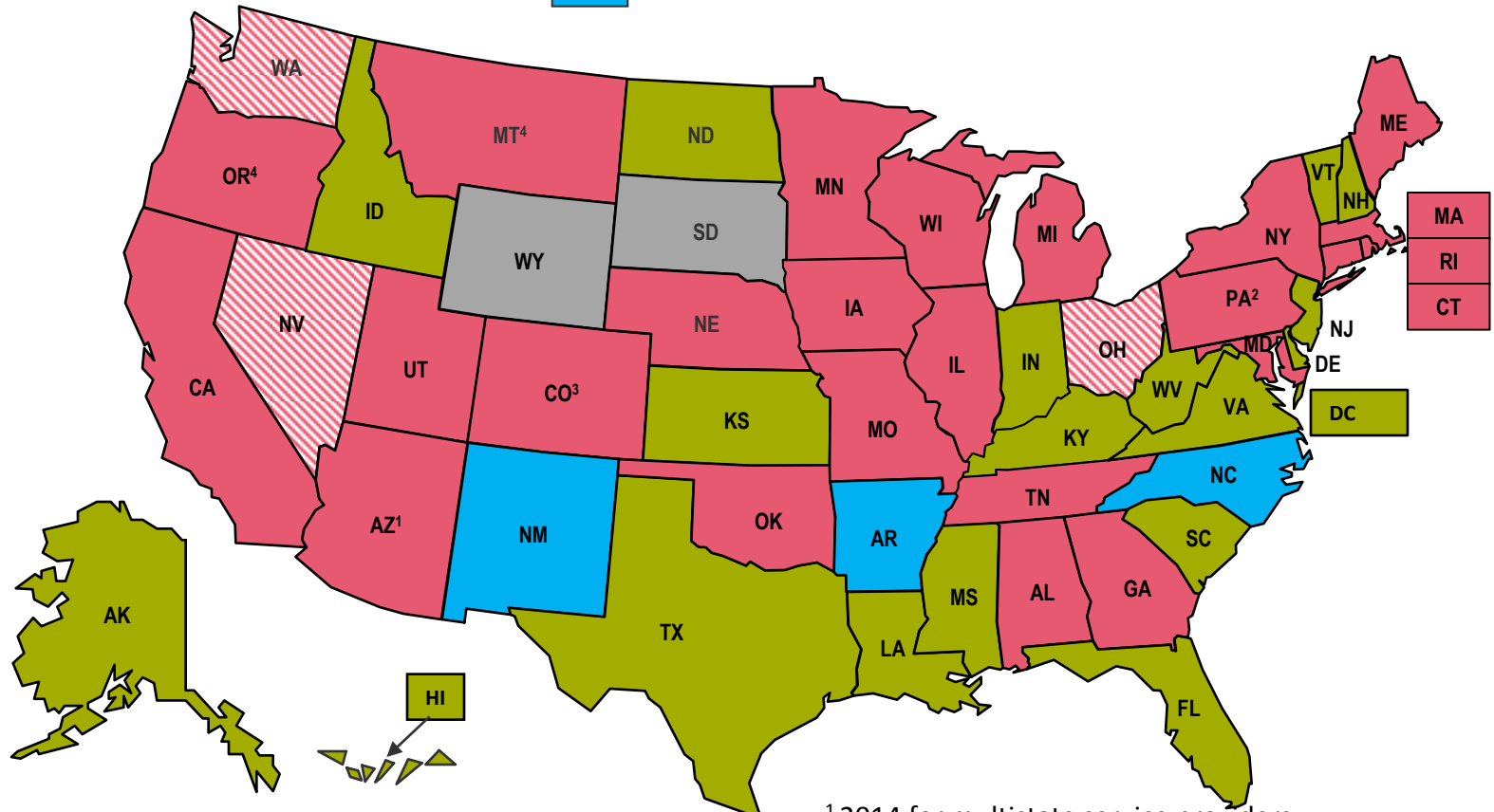


# **Income Tax Updates**

# Sourcing of Receipts from Sales Other Than of Tangible Personal Property

## Key

Cost of Performance – Services and Intangibles	
Market Based Sourcing – Services and Intangibles	
N/A State - No corporate income tax or GRT	
Legislation Pending in 2017 (OR, NC, AR, MT, NM)	



<sup>1</sup> 2014 for multistate service providers.

<sup>2</sup> Effective 2014 for service receipts only.

<sup>3</sup> For receipts from sales of intangible property only.

<sup>4</sup> Effective 1/1/2018.

# Market Sourcing - Rulemaking

- MTC finalized Section 17 (General Allocation and Apportionment) Regulations on 2/24/2017
  - Updated definitions of “business income” (now “apportionable income”) and “sales” (now “receipts”)
  - Adopts market-sourcing approach
- MTC Section 18 Rulemaking – working group met 4/25/2017
  - Issues to address:
    - Possible distortion caused by the exclusion of functional receipts from the definition of “receipts”
    - Exceptions to the definition of “receipts”
    - Whether receipts from factoring of receivables should ever be included in the receipts factor
    - Any situations where general population data might result in distortion and what methods might be used to address that distortion
    - The need for a “de minimis rule” for sourcing of receipts
    - Regulations that might be needed to interpret and implement the amendments to Article IV, Section 18 made by the Commission in 2015
    - Other special industry rules that might be necessary



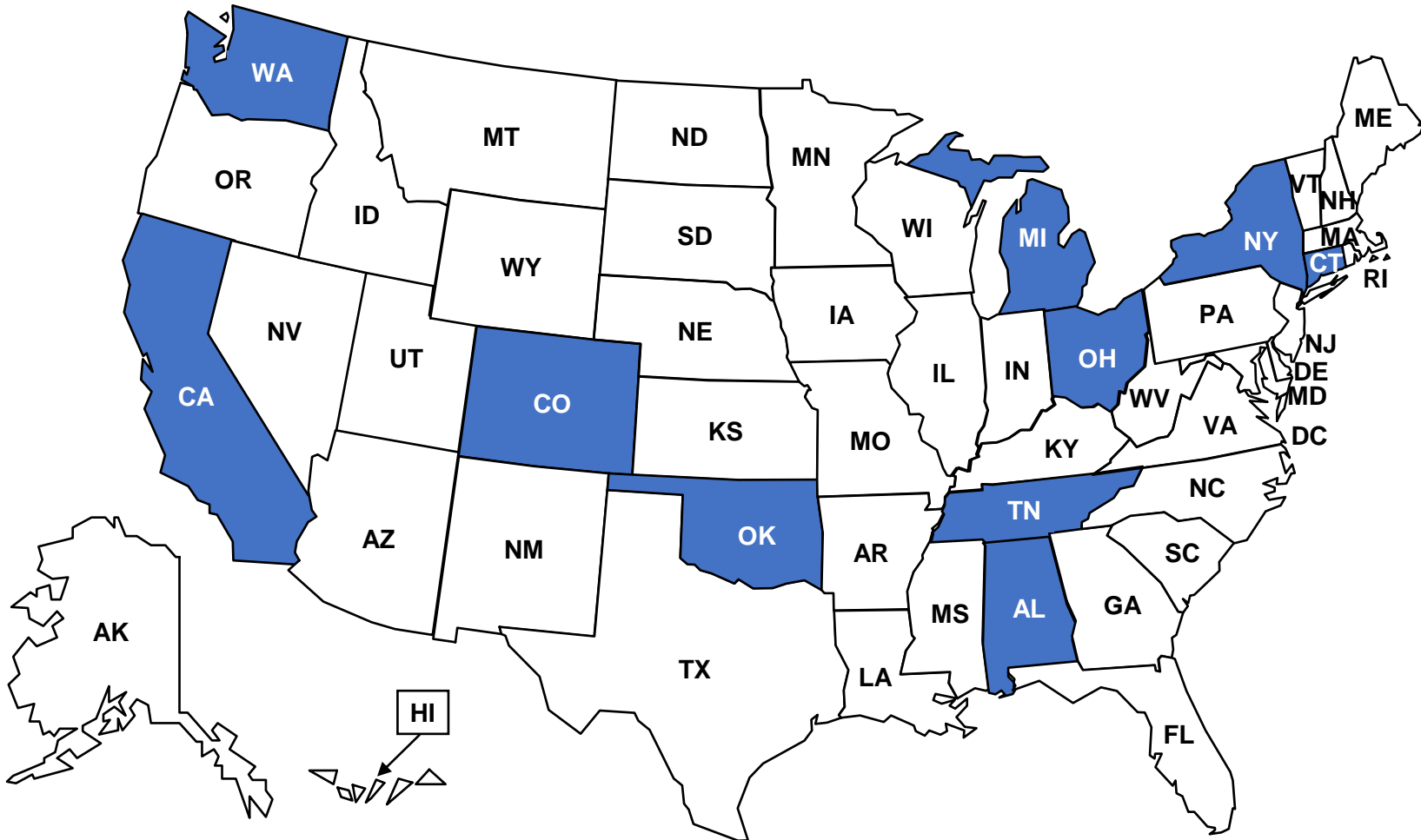
# Nexus – Factor Presence Statute Challenges

*Crutchfield v. Testa*, Ohio Supreme Court Case No. 2015-0794 (Nov. 17, 2016)

- Court also held against *Newegg* and *Mason Cos.* in similar cases on same day
- Online sellers with no physical presence in Ohio, but over \$500,000 in gross receipts found to be subject to CAT
- Ohio CAT's factor presence meets constitutional requirements for substantial nexus and that *Quill's* physical presence rule does not apply to gross receipts taxes
- The court did not address the issue of whether internet cookies create physical presence, an argument the state raised
- Cases settled, so no appeal to the U.S. Supreme Court
- Ohio was the first state to pass the MTC's factor nexus model legislation with its 2005 tax reform.
- At least thirteen other states have factor nexus provisions (among them: AL, CA, CO, CT, MI, NY, OK, TN and WA)
- Focus on these laws may now trend towards the statutes being unconstitutional "as applied" to a taxpayer v. "facially unconstitutional."

# Factor Presence Nexus – Business Activity Taxes

● States with factor presence nexus provisions



# Transfer Pricing – Utah

***See's Candies, Inc. v. Utah State Tax Comm'n***, No. 140401556 (Utah 4<sup>th</sup> Circuit, Oct. 7, 2015)

- See's Candies deducted IP royalty payments made to an insurance company also owned by Berkshire-Hathaway
- The Tax Commission argued that it could adjust See's income for the royalty payments based on the state's Sec. 482-style adjustment statute without reference to federal rules on related-company adjustments
- Court held that the Commission abused its discretion in failing to consider federal Sec. 482 guidance and failing to look at See's transfer-pricing study
- Court approved See's deduction, less a 10% adjustment determined after an MTC audit



# **States' Remote Seller Collection Efforts**

# States' Focus Shifts to the Courts

“Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsideration of the Court’s holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.”

– Justice Kennedy in *DMA v. Brohl*, March 3, 2015

# South Dakota's Anti-*Quill* Legislation & Litigation

- SB 106 (effective May 1, 2016) requires remote sellers without a physical presence in the state to collect and remit South Dakota sales and use tax on sales in the state if in the prior or current calendar year the retailer either:
  - Makes in-state sales exceeding \$100,000 or
  - Makes 200 or more separate sales transactions
- The South Dakota Sixth Judicial Court ruled that SB 106 is unconstitutional
  - *South Dakota v. Wayfair, Overstock.com and Newegg*, 32CIV 16-000092 (March 6, 2017)
- South Dakota filed notice of appeal to South Dakota Supreme Court on March 8, 2017

## South Dakota Sales Factor / Transactional Nexus – Thus far – Unconstitutional

- On March 6, 2017, the South Dakota Sixth Judicial Court ruled that the state's economic nexus legislation is unconstitutional (*South Dakota v, Wayfair, Overstock.com and Newegg*, 32CIV 16-000092).
- The legislation (effective May 1, 2016) required remote sellers without a physical presence in the state to collect and remit SD S&U tax on sales in the state if retailer:
  - makes in-state sales exceeding \$100,000, or
  - makes 200 or more separate sales transactions in the previous *or* current calendar year
- Case now pending before the State's Supreme Court – Oral arguments will be held on Aug. 29, 2017.
- Alabama's litigation on its \$250,000 threshold is still pending before Alabama's tax tribunal



# Sales Factor/Transactional Nexus – Sales & Use Taxes

legislation introduced in 2017 
  enacted by legislation 
  enacted by regulation 
  >\$100k OR 200 transactions

>\$10k in sales OR subject to Notice & Reporting

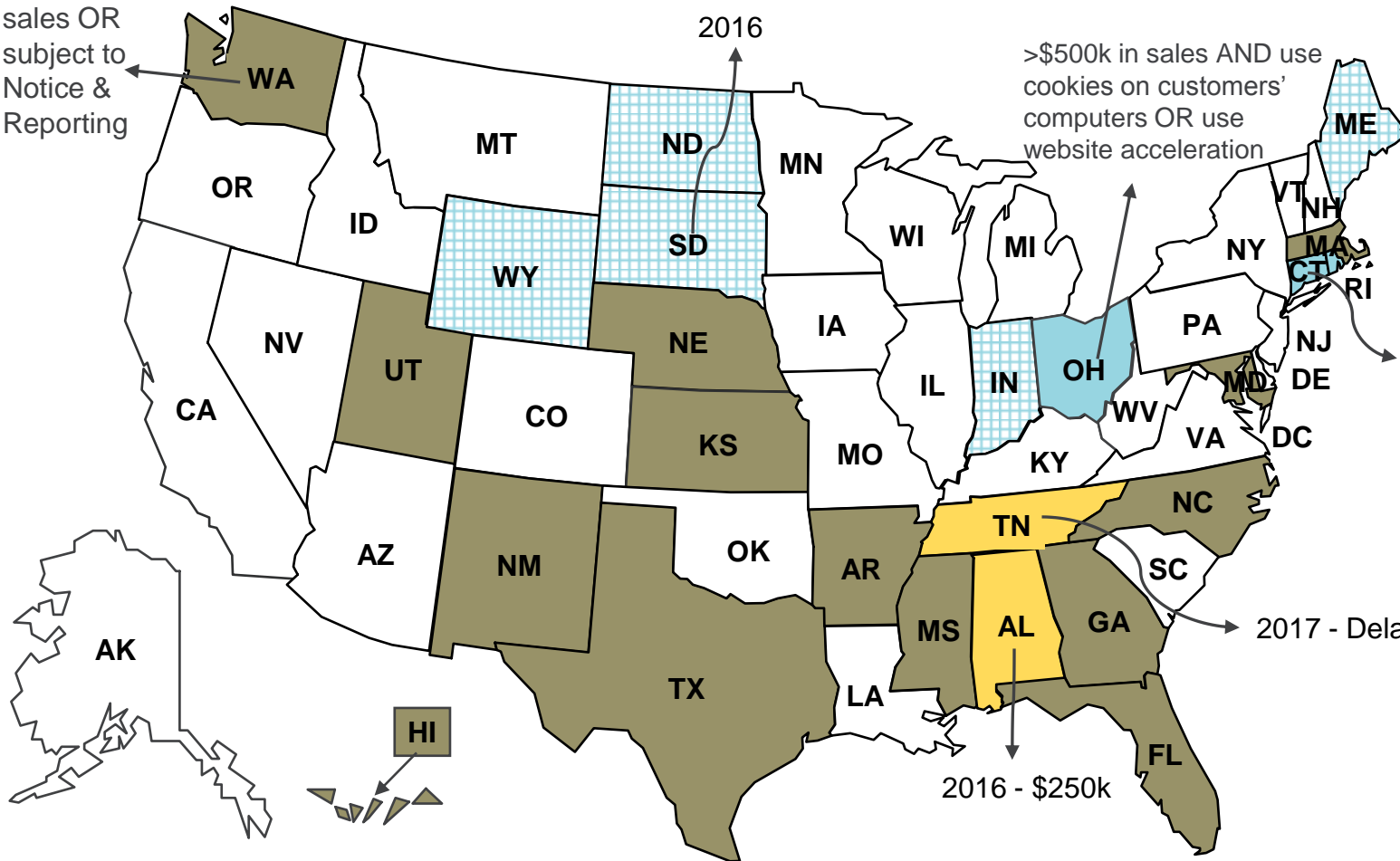
2016

>\$500k in sales AND use cookies on customers' computers OR use website acceleration

1989 law, notice 92(19) repealed Dec. 2013. Must have 100 transactions.

2017 - Delayed

2016 - \$250k



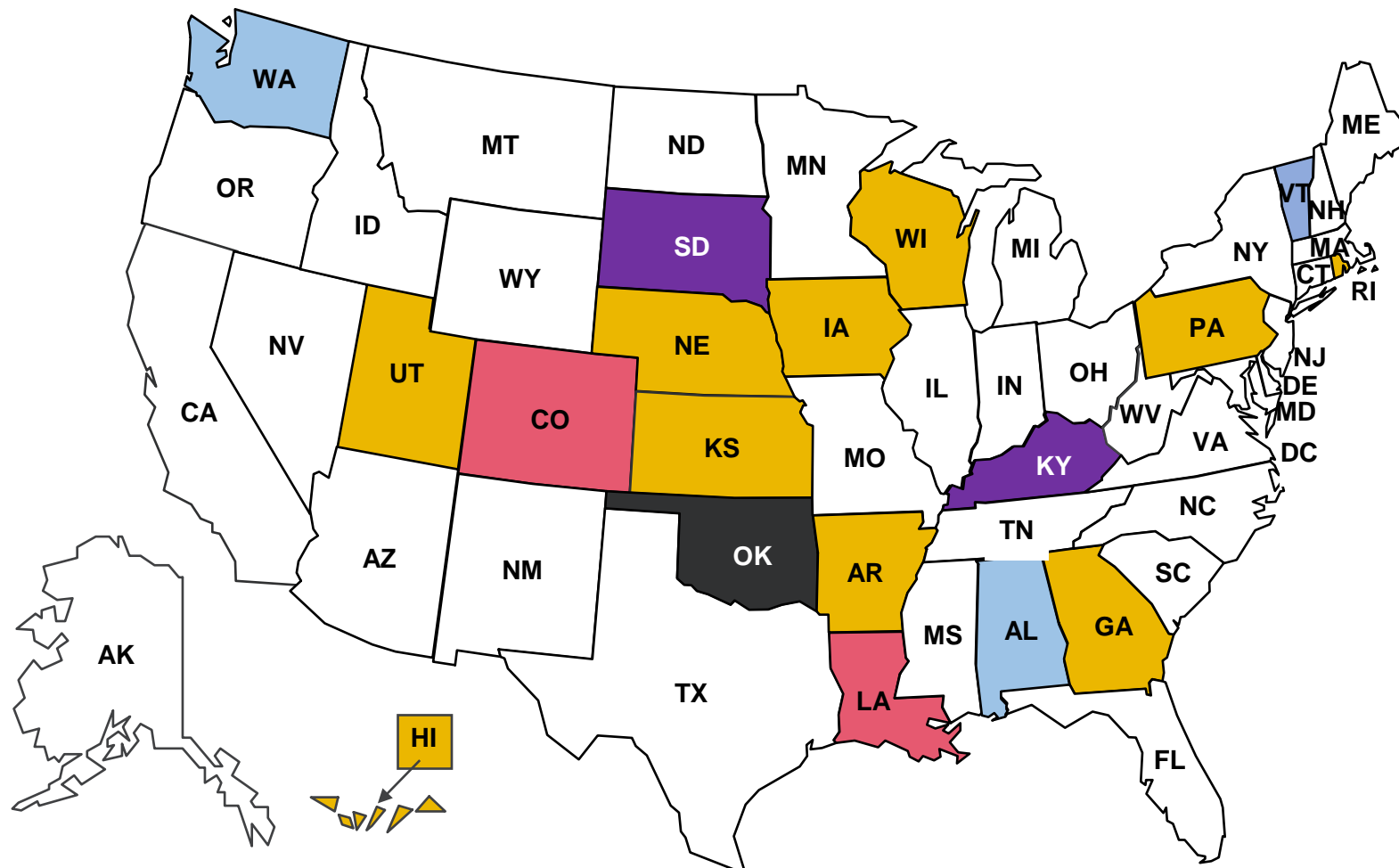
# State Legislative Considerations

States are considering three primary options:

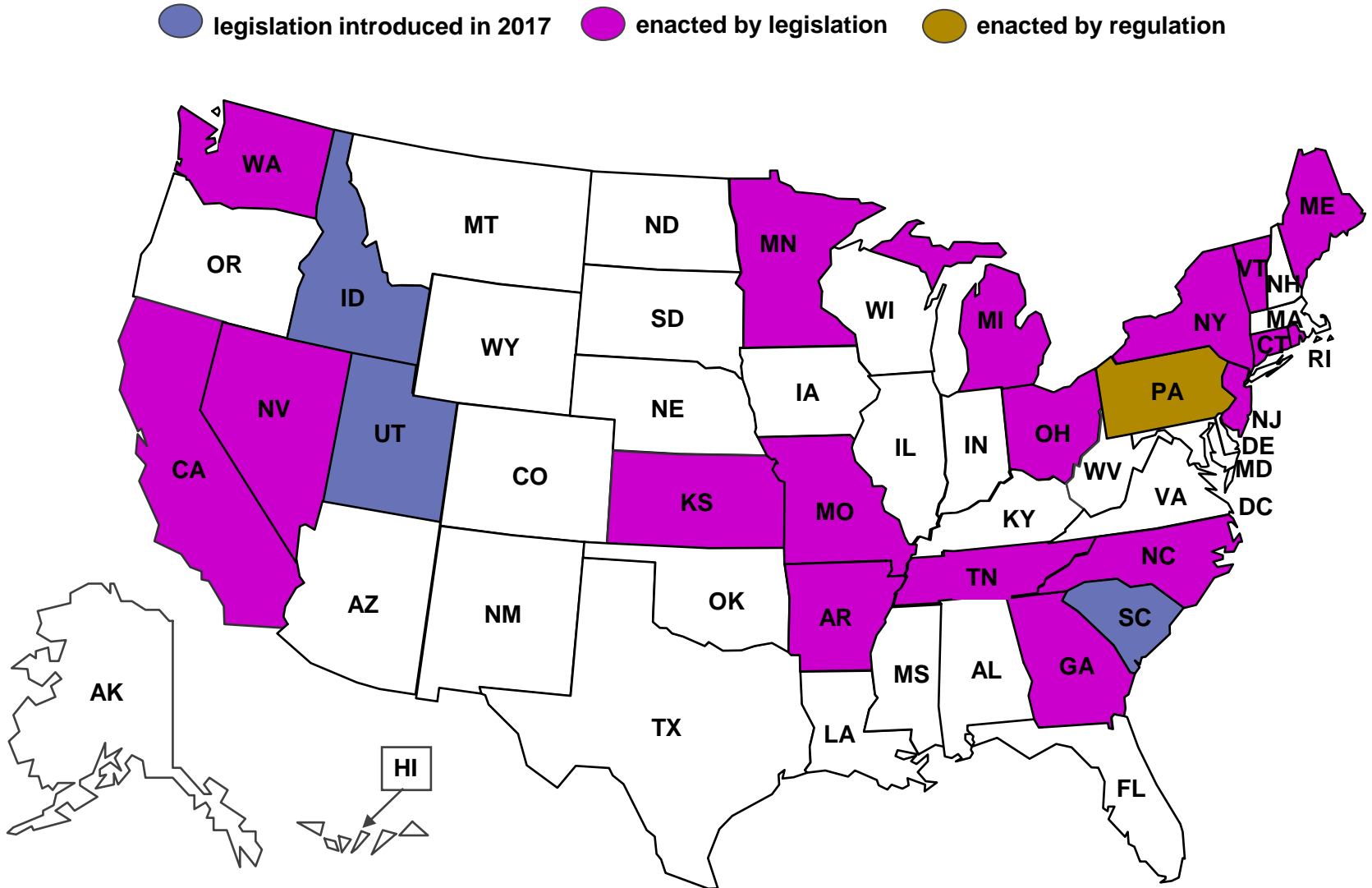
- I. Reporting requirements regarding sales into the state
- II. Nexus expansion provisions to increase the scope of state 'doing business' language.
- III. Marketplace collection/reporting provisions to require online and other marketplaces to collect and remit, or report, sales and use tax if a retailer sells products on the marketplace.

# Notice and Reporting in 2017: Sales Tax

● legislation introduced in 2017 ● taxpayer and the Department ● taxpayer only ● notification only

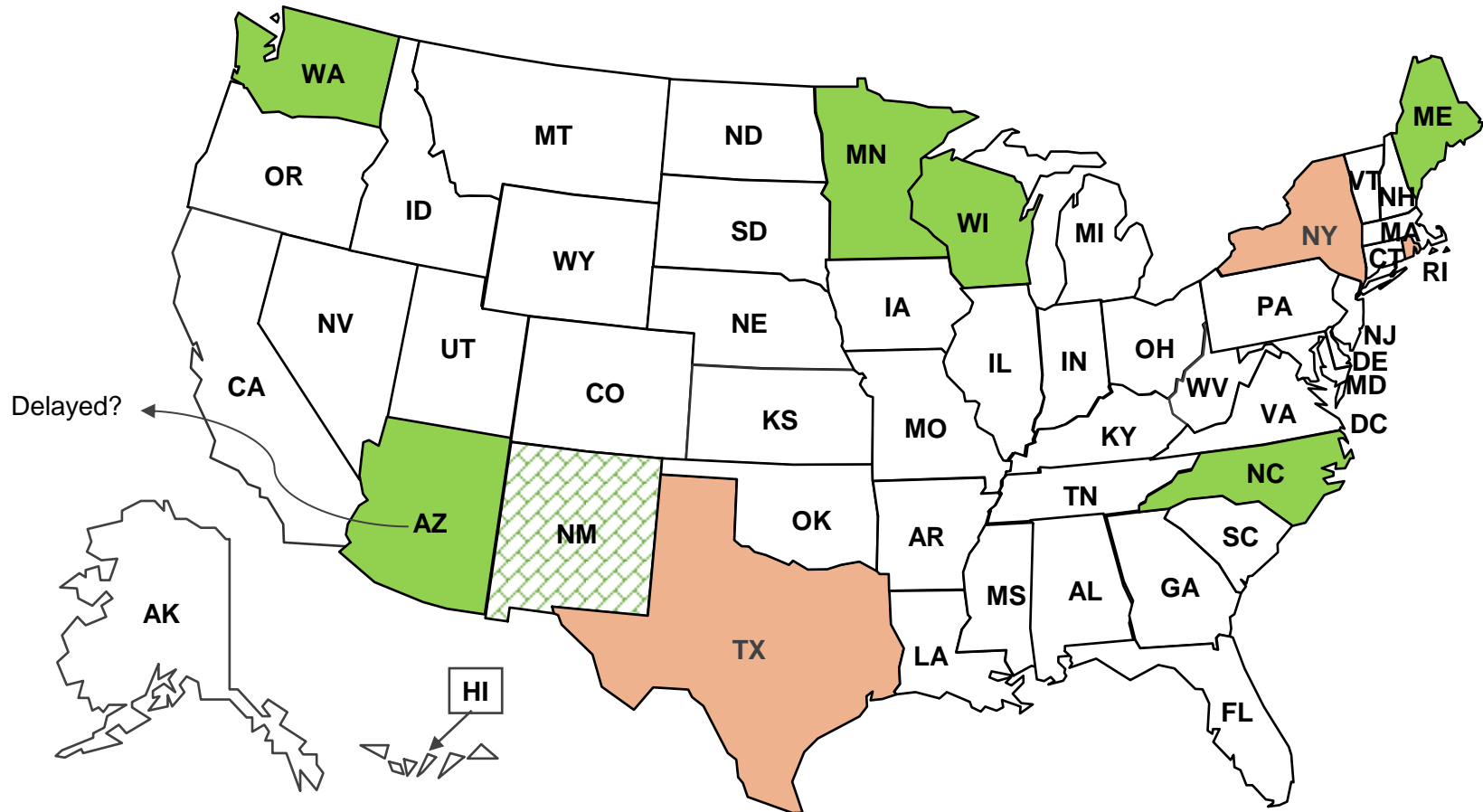


# Click-Through Nexus in 2017: Sales Tax



# Marketplace Provider in 2017: Sales Tax

● legislation introduced in 2017   ● enacted by legislation/regulation   ● Bill vetoed

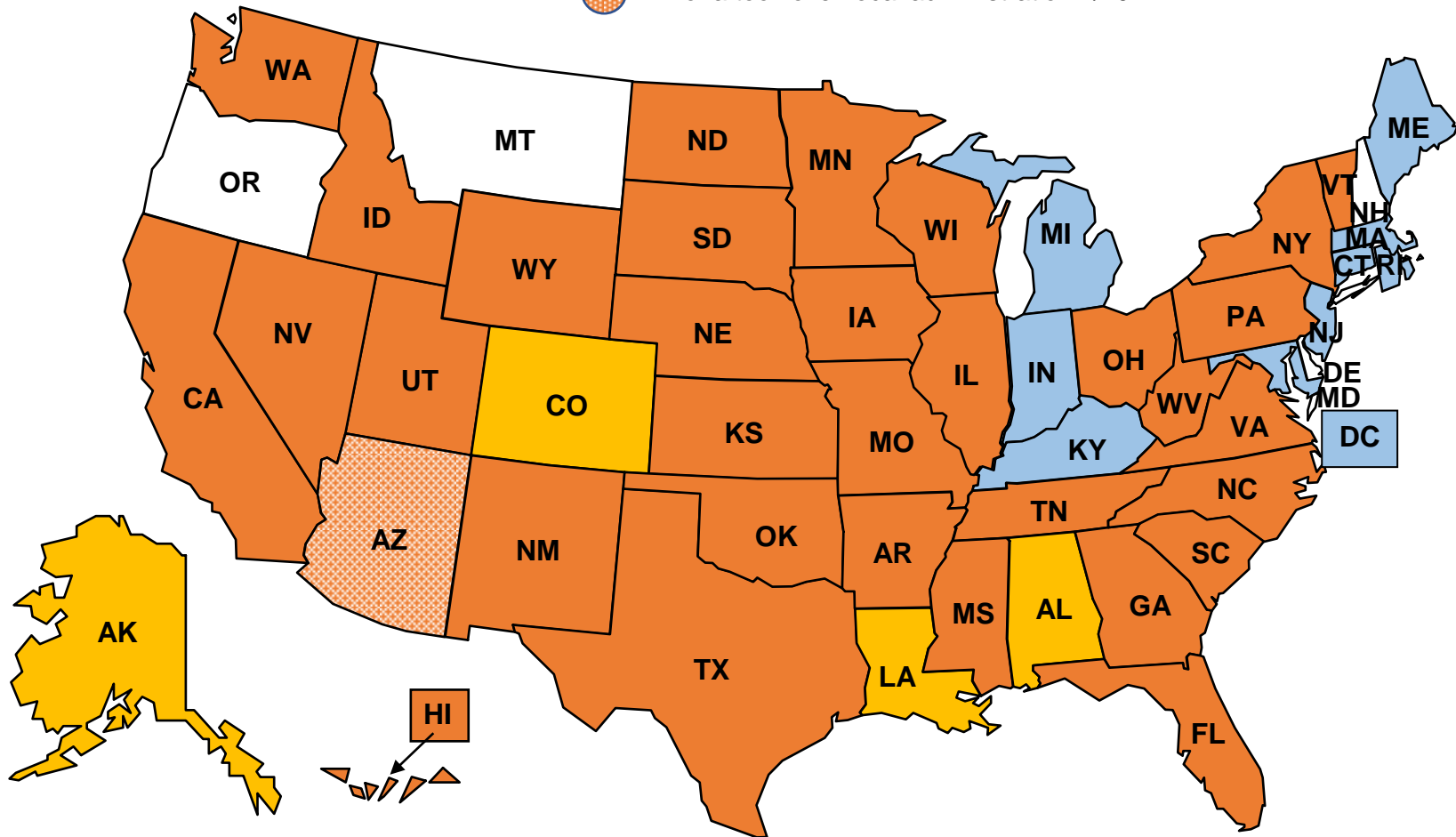


# Sound Tax Policy and How Arizona Stacks Up

Sound Sales Tax Policy			
	Colorado	Utah	Arizona
<i>Uniform Tax Base Definitions– State and Local</i>		★	
<i>One Tax Base – State and Local</i>		★	
<i>Central Registration – State and Local</i>		★	★
<i>Single Payment &amp; Audit – State and Local</i>		★	★
<i>Use of CSPs – Technology to Assist Sellers in Tax Collection</i>		★	
<i>Tax Appeals at Central Level</i>		★	★

# States with Local Sales Tax Jurisdictions – Kudos to Arizona!

- states with local administration of sales tax   ● 34 states with local tax jurisdiction(s)   ● 9 states with no local tax jurisdiction
- Arizona took over local administration 1/2017





# Non-SSUTA States Encouraged to Seek Membership to the SSUTA

## SSUTA Benefits:

- Clear path to remote seller collection under proposed federal legislation
- Treats instate sellers the same as remote sellers (level playing field) except for states' having to cover instate sellers' CSP services
- Uniform definitions and disclosed practices – state toggles what it wants to tax
- States police themselves for compliance
- Uniform return and exemption certificate
- Business input to (not control of) SSUTA Governing Board
- Agreement is not stagnant – amended on regular basis to address state issues and issues raised by business



# Property Tax Updates

# Property Tax: Good v. Bad

## The Good

- ▶ Stable revenue source
- ▶ Mass appraisal valuation data
- ▶ Fairly easy to administer
- ▶ Funds local government operations

## The Bad

- ▶ Not based on ability to pay
- ▶ Valuations can be subjective
- ▶ Complex appeals and battle over appraisals
- ▶ Refunds create budget issues

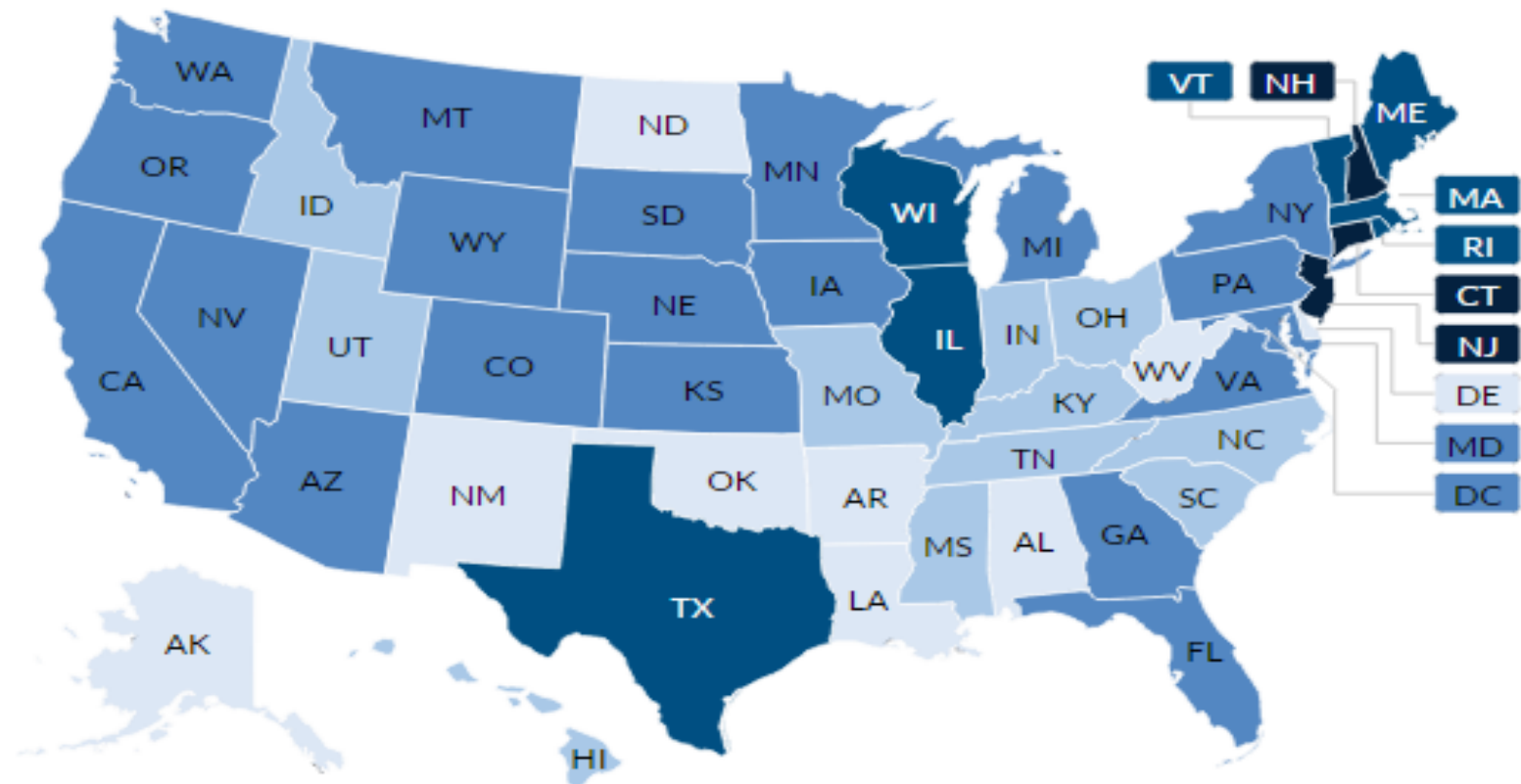
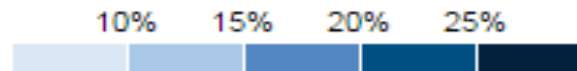
# OECD Statistics: Selected Countries

- **Property taxes as a % of GDP (2012)**
  - United Kingdom 3.92
  - France 3.75
  - Canada 3.26
  - **USA 2.88 (# 4 on the list)**
  - Italy 2.67
  - Australia 2.36
  - New Zealand 2.05
  - Greece 1.89
  - OECD average 1.78
  - Germany 0.92

# Importance of Property Tax as State & Local Government Revenue Source

## Property Tax Revenue, 2012

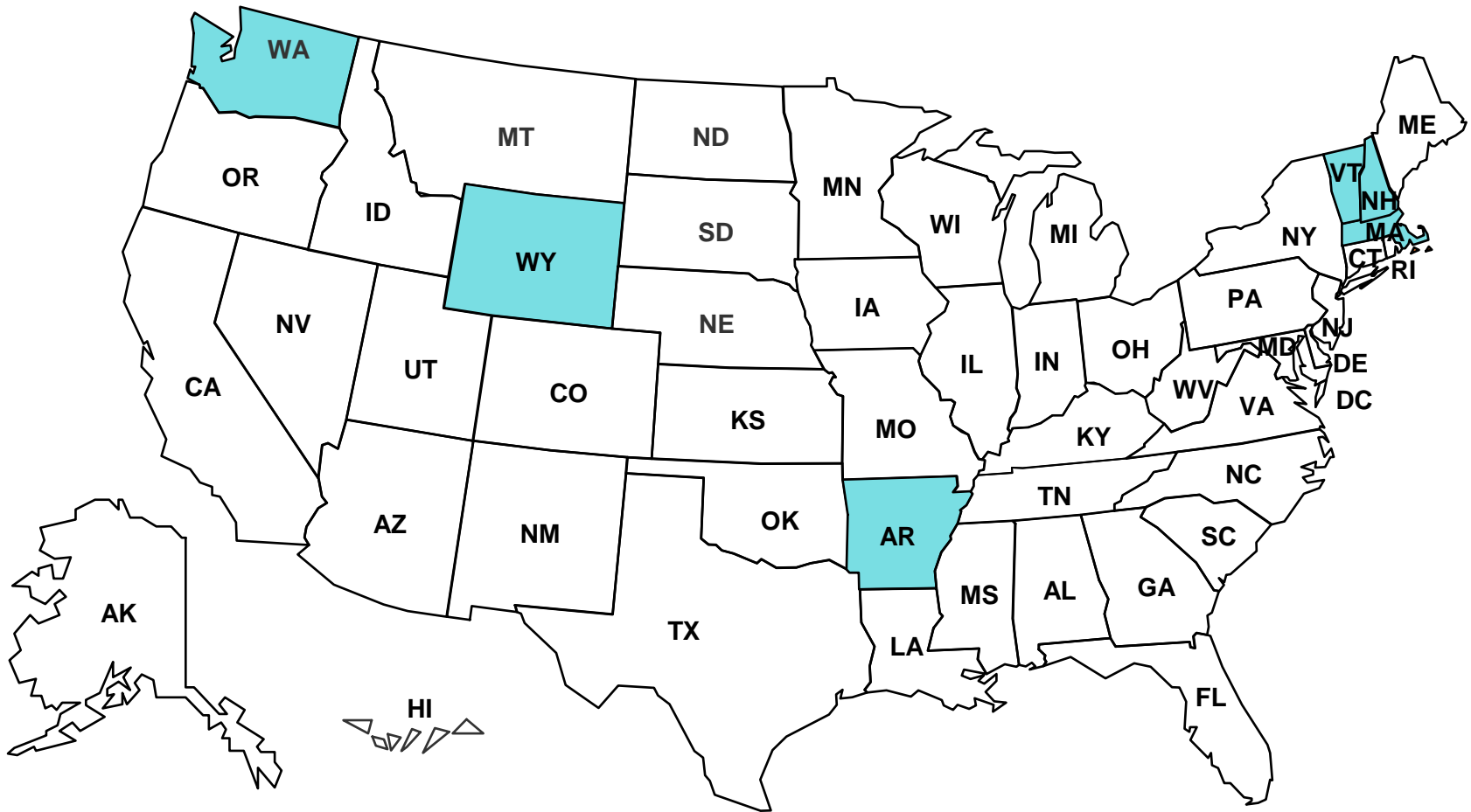
Percentage of General Revenue (%)  
US: 17.2%



Source: Census

# State Level Property Tax Reliance is Much Less

Property Taxes Make Up More Than 10% of Tax Revenue



Source: [fivethirtyeight.com](http://fivethirtyeight.com)

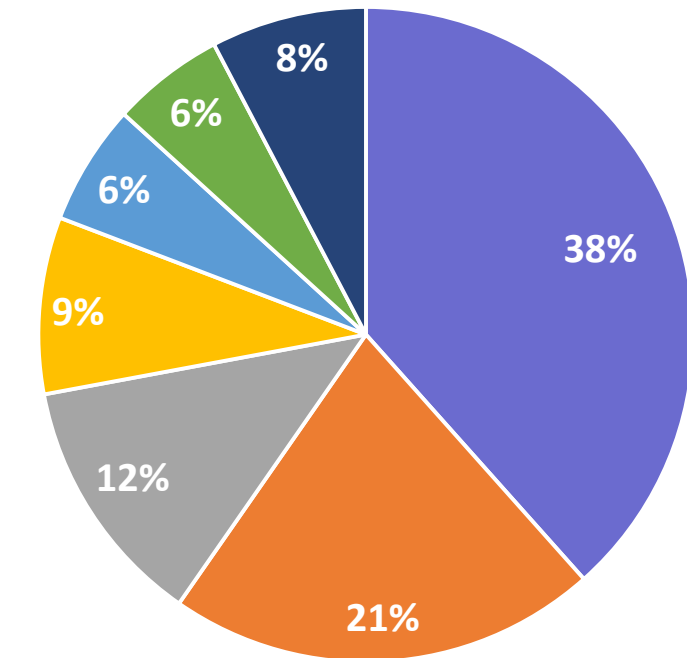
*"Where Your State Get Its Money" (2014 Tax Revenues)*

# Funding Public Education

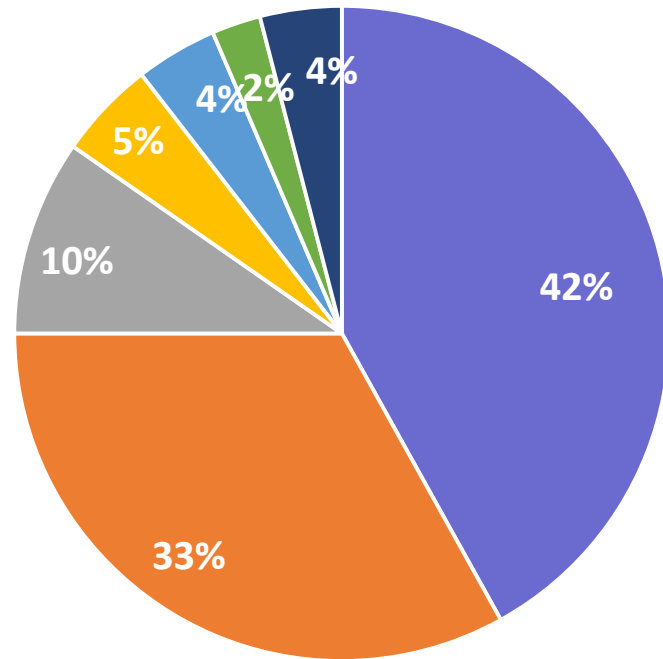
- ▶ **Approximately 70% of the revenue from local property taxes are used to fund public K-12 education.**
  - Over 90% of the local property taxes in Texas and Illinois fund public K-12 education
  - Rhode Island and Vermont use less than 10%
- ▶ **However, local property taxes, on average, only fund 36% of public education -- other local revenue and state taxes pick up 54% -- the federal government contributes 10%**



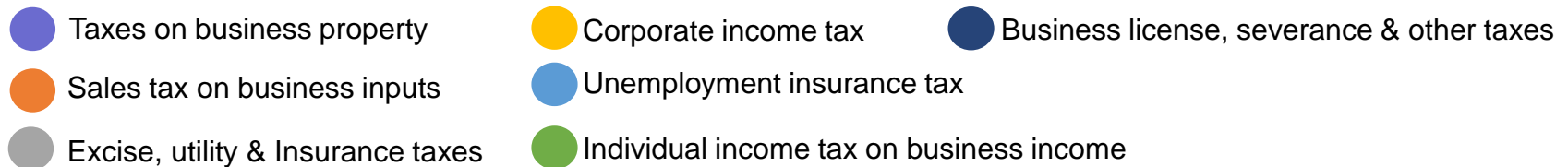
# Property Taxes Make Up the Largest Portion of Business SALT



**United States**

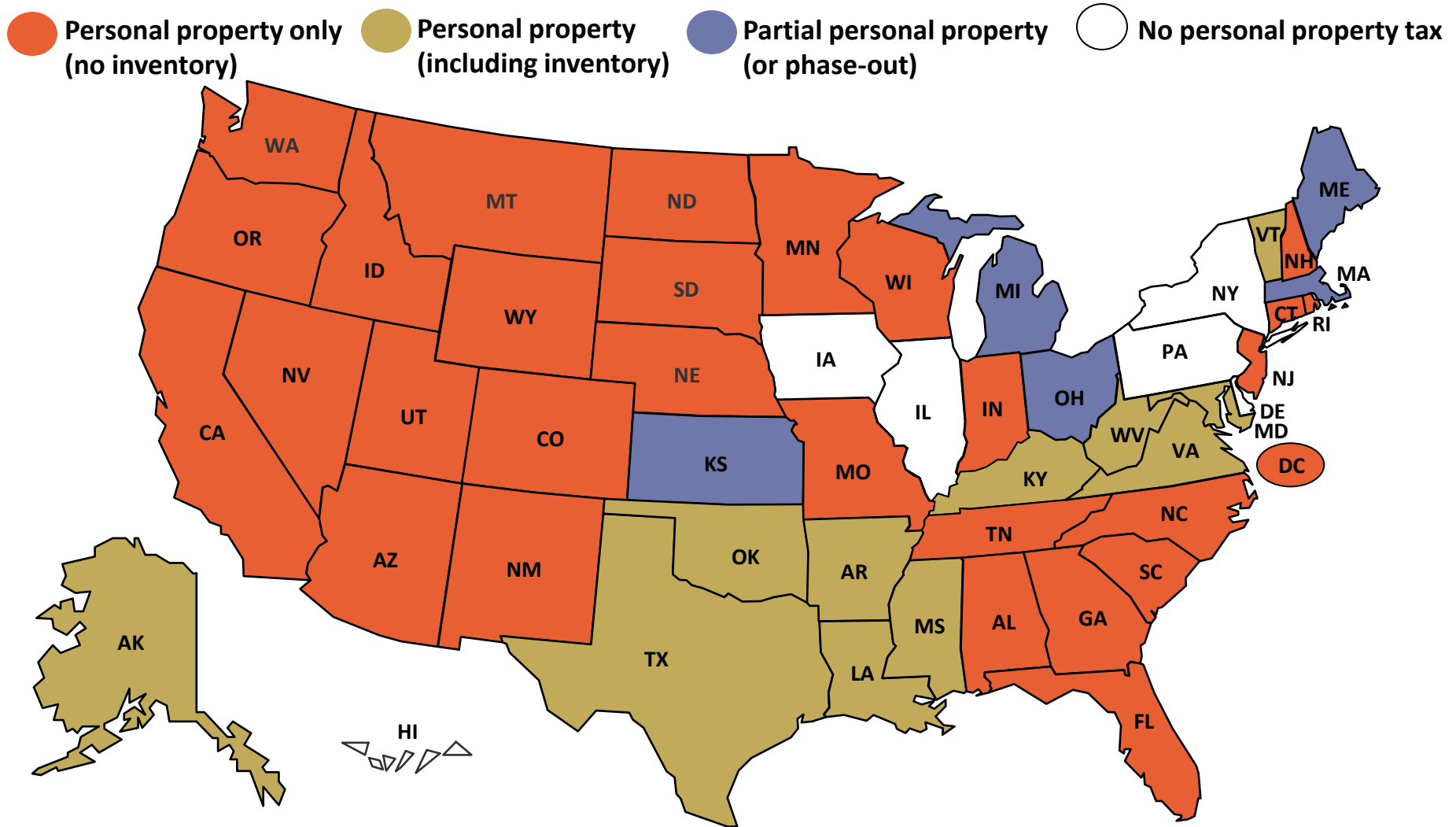


**Arizona**



Source: COST, STRI, Ernst & Young: "Total State and Local Business Taxes: <sup>37</sup> State-by-State Estimates for Fiscal Year 2016"

# ALL STATES TAX REAL PROPERTY



# It's All About the Effective Tax Rate

Valuation	\$1,000,000	\$1,000,000	\$1,000,000
Assessment Rate	100%	50%	75%
Deductions	0	0	50% Exclusion based on value - \$500,000
Taxable Value	\$1,000,000	\$500,000	\$250,000
Tax Rate	1%	2%	4%
Tax Due	\$10,000	\$10,000	\$10,000
Eff. Tax Rate	1%	1%	1%

Using less than a 100% assessment rate on the fair market value of property just increases the nominal tax rate that must be imposed to produce the same level of revenue.

# Property Tax Rate Disparity

**Scenario:** Property tax manager for a company has been asked to look at the following locations to build a plant. The facility will cost \$25 million, 50/50 split between real and personal property. Where would you build the plant?

## Lowest Tax Locations (50 largest US Cities)

- Virginia Beach, VA	\$274k in yearly property taxes	Eff. Tax Rate: 0.549%
- Seattle, WA	\$358k in yearly property taxes	Eff. Tax Rate: 0.717%
- Louisville, KY	\$376k in yearly property taxes	Eff. Tax Rate: 0.753%

## Highest Tax Locations (50 largest US Cities)

- Detroit, MI	\$1,495k in yearly property taxes	Eff. Tax Rate: 2.990%
- San Antonio, TX	\$1,411k in yearly property taxes	Eff. Tax Rate: 2.822%
- El Paso, TX	\$1,408k in yearly property taxes	Eff. Tax Rate: 2.817%

Source: Lincoln Land Institute & Minnesota Center for Fiscal Excellence, 2017 50-State Property Tax Comparison Study (taxes paid in 2016)

# **Common (Shared) Goals: Taxpayer & Tax Assessors**

## **Efficient & Effective Tax Administration**

- Ability to Comply with Laws/Regulations
- Cooperation
  - Complete Audits in Timely Manner
- Transparency
  - Publication of Administrative Decisions
- Adequate Revenue
  - Need stable tax base to support government operations

# **COST Administrative Scorecards**

## **Four Administrative Scorecards**

- State Administrative Practices Scorecard
- Unclaimed Property Practices Scorecard
- International Property Tax Administrative Scorecard
- Sales Tax Administrative Scorecard (*forthcoming*)

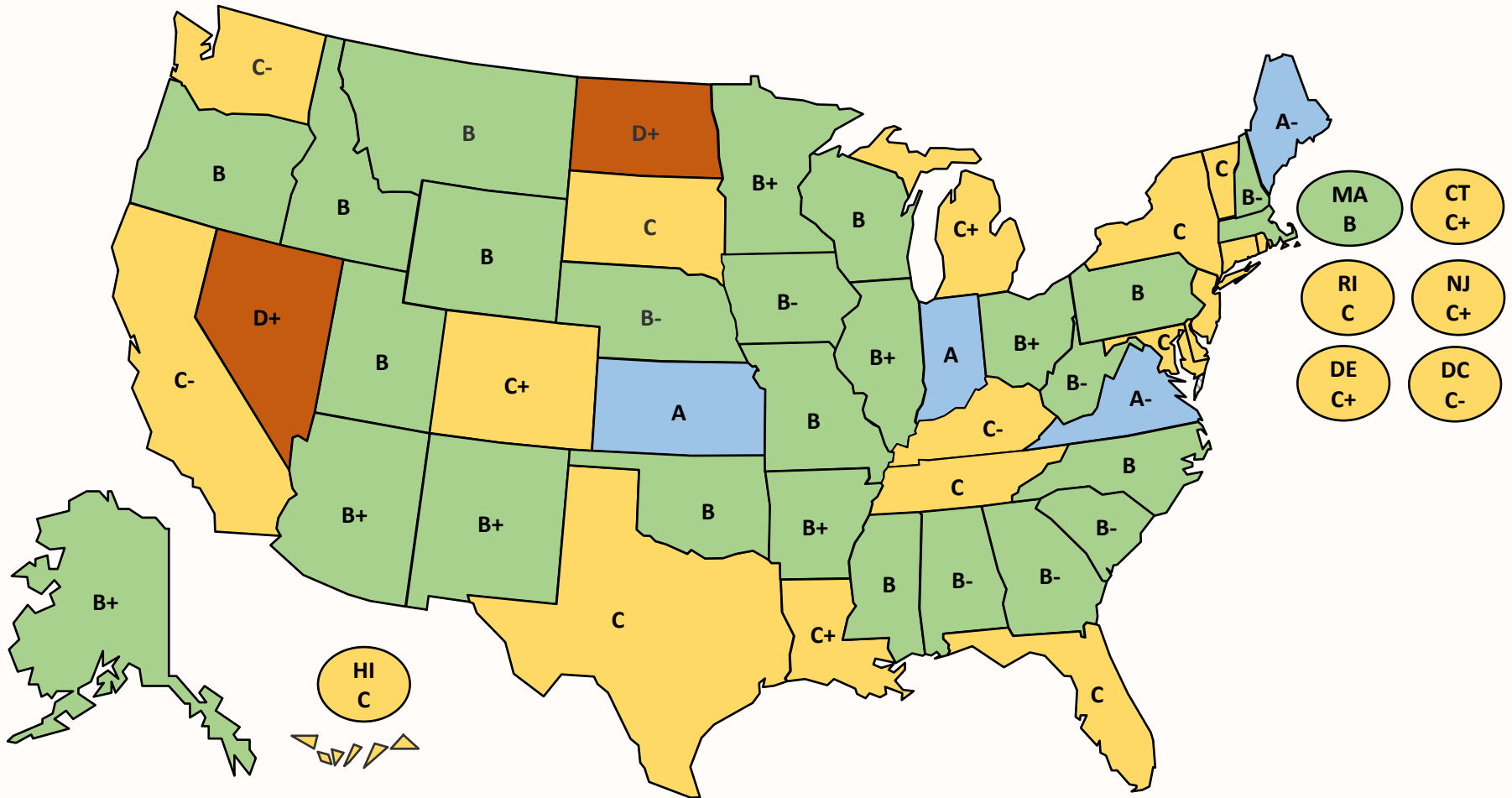
*Goal is to work with both the legislative and executive branches of state government to improve state and local tax administration*

## **COST 2016 State Administrative Practices Scorecard**

- Areas Evaluated:
  - Independent Tax Dispute Forum
  - Pay-to-Play Tax Litigation System
  - Even Statute of Limitations/Interest Rates
  - Adequate Appeal/Protest Period
  - Return Due Date/Automatic Extension
  - Filing IRS (RAR) Changes
  - Transparency

# Overall Grades

## 2016 State Administrative Practices Scorecard





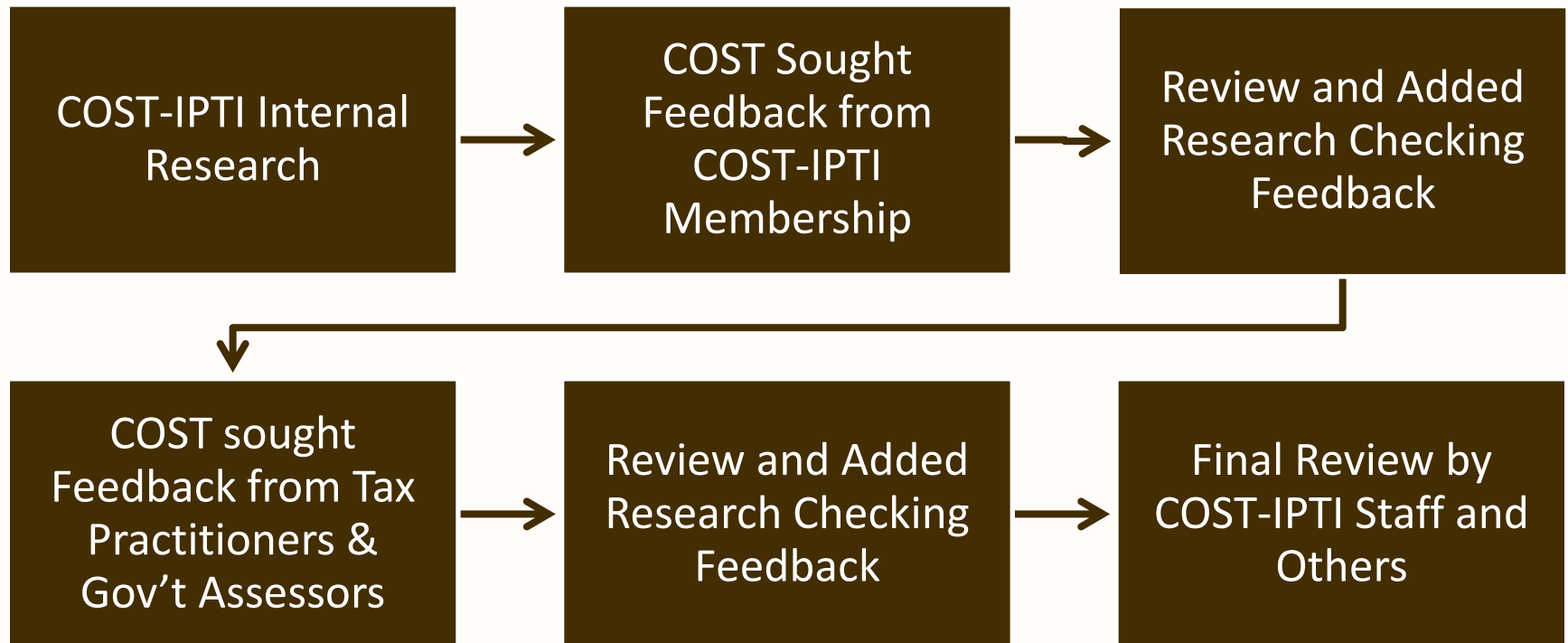
# **COST/IPTI 2014 International Property Tax Administration Scorecard**

- Three Areas Evaluated
  - Transparency
  - Simplicity and Consistency
  - Procedural Fairness
- U.S., as a whole, did not do as well as other countries: Canada, United Kingdom, Australia, Hong Kong, & South Africa

# COST/IPTI Scorecard

- COST focussed on the USA
- International Property Tax Institute (IPTI) focussed on other countries:
  - United Kingdom; Canada; Australia; New Zealand; Hong Kong; Ireland and South Africa
- COST seeks your input on the next version of the COST/IPTI Scorecard – it will be completed this year (2017)

# Scorecard Evaluation Process



# Highest and Lowest Jurisdictions

## Top State

Indiana (B)

## Bottom States

Pennsylvania (D)

Puerto Rico (D)

Nevada: (D+)

## Top Non-US Country

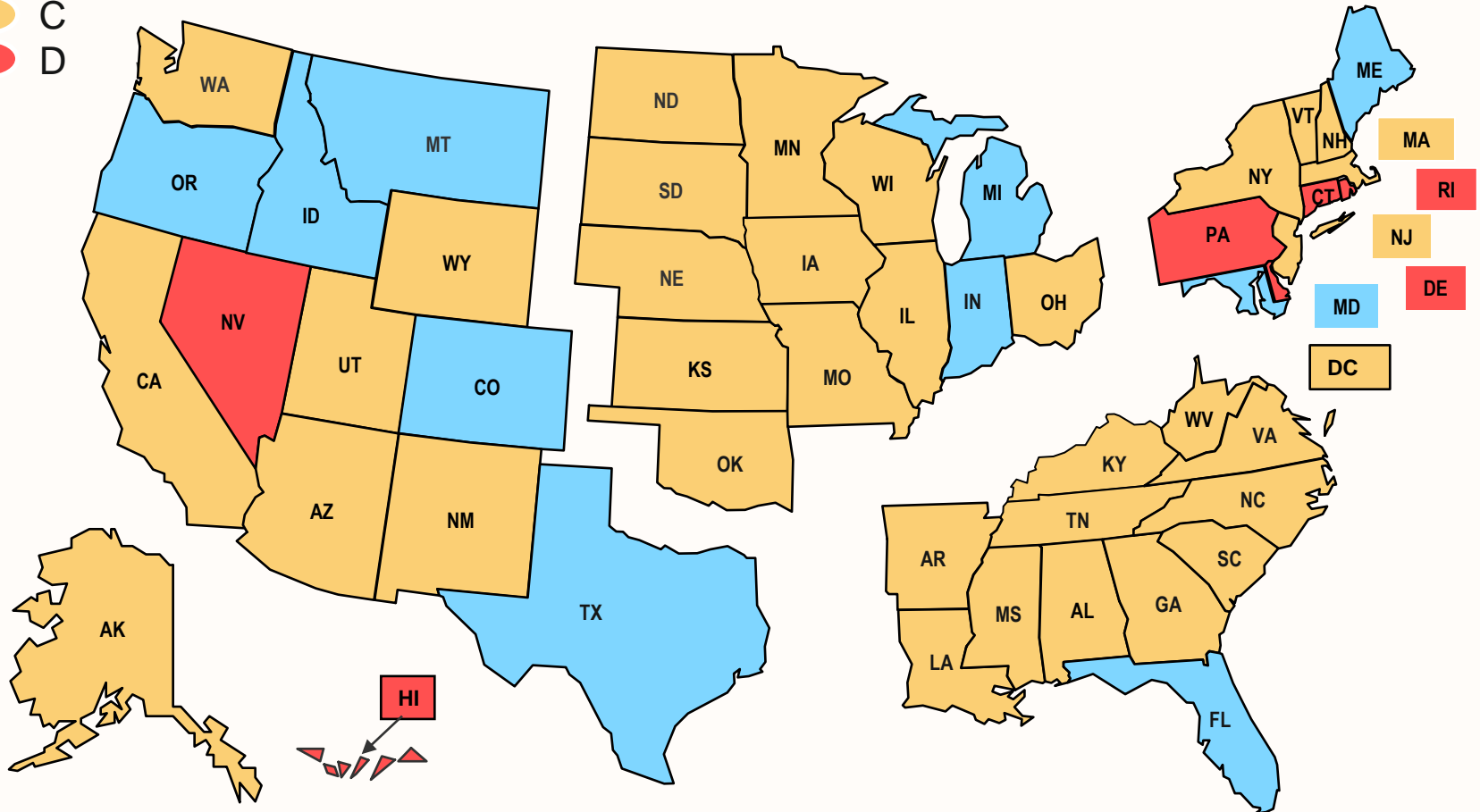
Hong Kong (A-)

## Bottom Non-US Country

North Territory, Australia (D+)

**Arizona (C)**

# Property Tax Overall Grade



# Arizona's Opportunities for Improvement

- DOR's property tax website section could be improved (contain law & regs)
- Personal property tax should have *de minimis* provision (statewide)
- Eff. tax rate 2.9 times higher on commercial/industrial to residential
- No ability to escrow/defer paying disputed tax
- Centrally assessed property has different salvage value floor and treatment of intangible property

# Questions?

# THANK YOU!

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